DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

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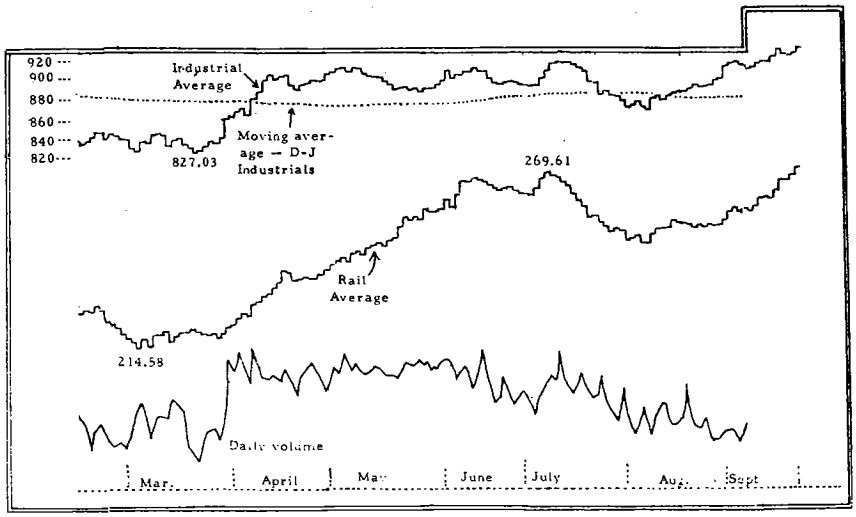
THE MARKET: As of this writing, the Dow Industrial Average has posted a high (October 1) for the year of 942.32, a high that falls just 1 point short of the 1967 Dow peak of 943.08. The Rails on October 1 confirmed Industrials by bettering their own 1968 high of 269.61, recorded in mid-July. The D-J Utility Average has not joined in the rally at all, and at present the Utility Index is locked in the 130 area, just a fraction above its level of four months ago.

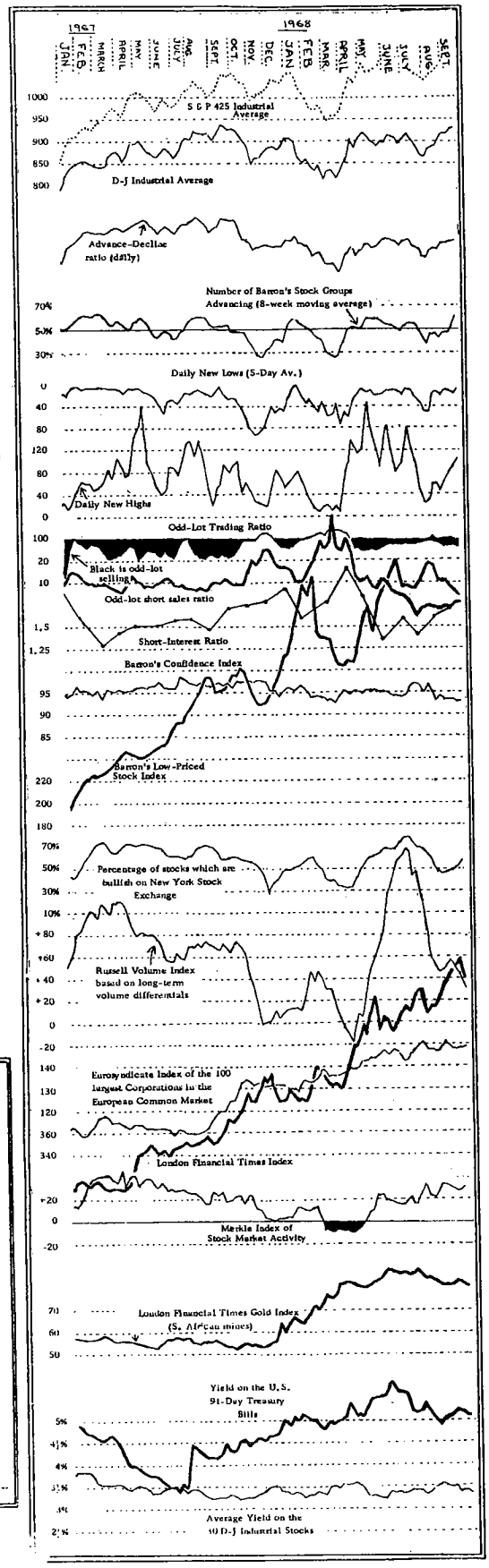
The breadth of the market (advance-decline ratio) has turned sluggish, with advancing days bringing in around 100 to 200 more advances than declines. The A-D ratio itself is still below its peak of the year established last July.

Volume has expanded sharply from its "low" ebb of late-July and August, and huge trading days in the 13 to 17 million shares are common again. Daily new highs, while rising, have not approached their peak of last June.

On page 2 I have included an interesting chart (statistics from Chartcraft) showing three categories of market strength which I follow. At the top we see the Dow Industrials at their new high for 1968—the 1968 peak being 942.32. The percentage of all stocks on the N.Y.S.E. which are bullish is now 57.5%, well down from its June peak of 76.1%. The percentage of 88 Standard & Poor Stock Groups which are bullish shows a late figure of 71.6% bullish. However, this too is well down from its July 3 peak of 84.3% bullish. Finally, the percentage of the 30 Dow stocks which are bullish has risen to 67%, and this is slightly above the May high for the year of 63%

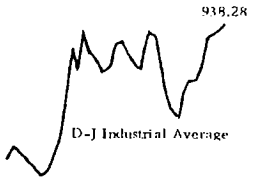
Thus, of three Averages and five technical indicators of strength, three are acting better than they were earlier in the year. The Dow Industrials and Rails are at a new high, and the percentage of Dow stocks in bullish trends is at a new high. Still lagging are



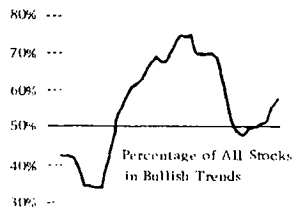

1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's Stock Groups Advancing (8-week moving average)
Daily New Lows (5-Day Av.)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 40 D-J Industrial Stocks

the Utility Average, the advance-decline ratio, the percentage of all stock in bullish trends, the percentage of all groups in bullish trends.

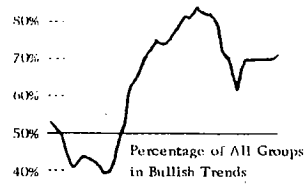
Add to this the daily new highs (which are lagging), and I would have to say that this market is not as strong as it was during May, June and July. I therefore continue to warn subscribers that we are witnessing the most deceptive secondary reaction ever seen within the framework of a primary bear market.



One of the potential conflagration points concerns American politics. From all reports, Richard Nixon is on his way to the White House. If so, there is a good chance he will take a harder line all around—on Vietnam, on inflation, on monetary affairs, on international affairs. In a way, this would seem to constitute some sort of belated "return to reality," a state which I do not believe the market has yet discounted.

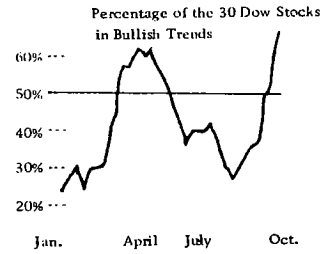


Therefore, it would not surprise me to see this market turn around any time between now and election time, as it begins the process of discounting the moment of truth. I have observed in the history of markets that the longer and more powerful a counter-primary trend movement, the longer and more powerful the ultimate true primary movement when it takes hold. If this is so, I would expect the coming plunge in the market to set some sort of record for severity and intensity.



Since October, 1966, an extended counter-primary trend correction has taken the Dow within 52 points of its bull market high during 1967, and within 53 points of its bull market high during 1968. During the coming 2 to 6 months I expect that the inflation-spurred counter-primary forces are going to exhaust themselves. When this happens the primary bear market will be on again with a vengeance.

I realize that there are few investors today who believe such a turn of events is possible. I also remember that the majority during the 1957 lows or the 1962 lows never foresaw that a year later the situation would be as different as night and day. In all history the public has never emerged from a primary bear market unscathed. Within a few years, I personally believe that most of today's 22 million investors will be wiped out.



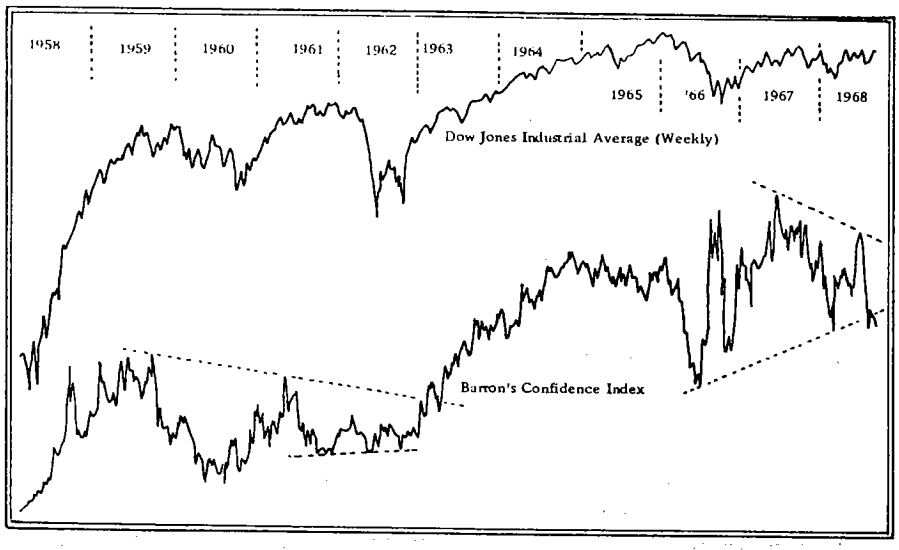
I have been asked what set of circumstances could turn this market to shambles and bring about a massive collapse in equity prices. This is my own personal theory. In the 1929-32 debacle the people went broke, but the Government remained solvent. I consider the Government's financial position tenuous today—far more vulnerable than it was during 1929. In the event of a cave-in, I believe the Government could do far less today than it did during the 1930's.

But the big difference today (as against 1929) is that half the nation is now under 25, and they are questioning everything, economic, social and political. They are currently in a state of semi-revolt during the greatest boom period in American history. What will happen if this boom collapses, if half-the-nation which is under 25 becomes totally disillusioned with what they have been told and what is happening? I do not profess to know the answers, but I do foresee this type of frightening confrontation. I believe the entire structure known as "the Establishment" will come under attack. In my opinion, the factors which could knock the market to its knees (and the Dow to perhaps 200 to 300) will be an upheaval which will question the very stability of the fabric of the nation—socially, economically, politically.

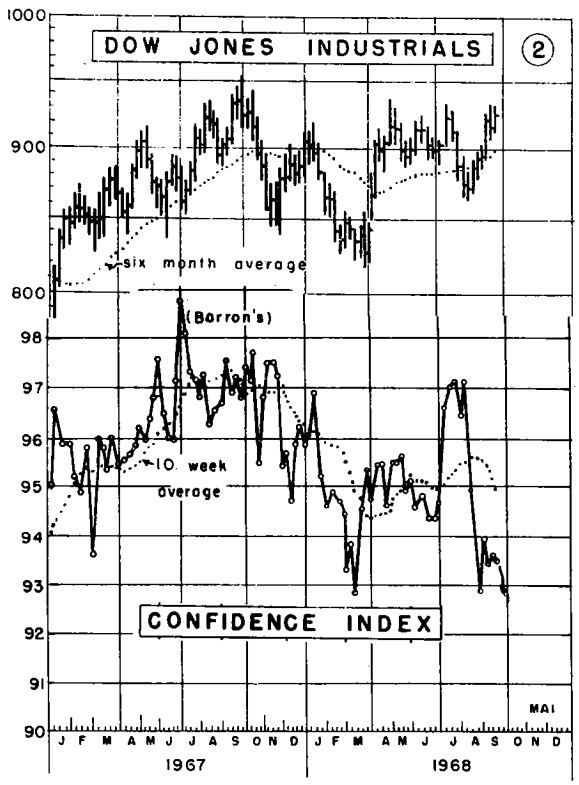
The outstanding thing about the Presidential campaign so far is the popularity of Wallace and the unpopularity of Humphrey. Talking about Humphrey and Nixon, Bill Mauldin (who was the outstanding cartoonist spokesman for my generation) stated recently, "They are both clowns." What he meant, I think, is that Nixon and Humphrey are both synonymous with the Establishment. The half of America which is under 25 does not identify with either of these men. Wallace represents a maverick and protest vote almost as much as does Eldridge Cleaver. I spoke to the chairman of our local McCarthy campaign, and after the Democratic primary was over he told me, "I'd vote for Nixon before I voted for Humphrey."

What he meant was that neither Nixon nor Humphrey represents what he sees or what he wants. His statement somehow startled me with its bitterness and anger. It is probable that half of America is unhappy with what the two major

parties have produced. They see Nixon as part of the Establishment and Humphrey as an appendage of L.B.J.'s and as much a part of the Establishment as Nixon. I have seldom seen a coming Presidential election start with such distaste on the part of so many people. I feel that both parties are essentially "out of it" as far as representing current thinking in this country.



The fact that Wallace, who five years ago would not have been taken seriously, is now supposed to command 21% of the votes, I take as a sign of a rising mass protest. All this the market will reflect in due time.



CONFIDENCE TEST: It has been said that the "art" of technical analysis consists of knowing what indicators to watch and what indicators to toss out. The history of technical analysis is one of fads. Periodically, one indicator or another gains popular favor, and at such times analysts go back and show how accurate a certain indicator has been (if it had only been followed) over a period of years. Almost magically, that indicator becomes the current technical fad—and just about that time this particular indicator ceases to function.

I have seen this happen with almost every technical indicator in the Wall Street technician's arsenal. At the same time, good indicators may drop from sight for years, simply because they have not worked too well for a period of time, or simply because analysts become tired of referring to them.

One such indicator is Barron's Confidence Index. This is actually the ratio of the yield on Barron's 10 Highest Grade Bonds and the yield on the broad D-J 40 Bond Index. Theoretically, the rationale behind the Confidence Index (C.I.) is this. Bond buyers tend to be more sophisticated than stock buyers. When bond buyers sense trouble, they move out of the higher yielding (but lower quality) D-J 40 Bonds into the quality type of bonds as represented by Barron's 10 Highest-Grade Bond Average. When this occurs, the C.I. reflects the change in yield ratios by declining. Conversely, when bond buyers are more optimistic about coming events they will speculate on higher yielding but lower quality bonds, the type represented by the D-J 40 Bond Index. Under such circumstances, the C.I. advances.

Historically, the record of the C.I. has actually been quite good. Without including endless paragraphs of interpretation, I have included a tracing of the D-J Industrials and the C.I. (weekly) from 1958 to present. Readers may study this valuable chart (tracing from Quote Digest) and draw their own conclusions.

In general, two observations may be made. First, the C.I. usually indicates coming changes in direction for the D-J Industrial Average. The C.I. does not necessarily deal with the amplitude of those reversals. Secondly, the C.I. has, in the past, indicated coming reversals in the trend of the Dow with a lead time of around two to four months.

With these rough "rules" in mind, I have also included a weekly chart of the Dow and the C.I.(see page 3) from Merrill Analysis, Box 228, Chappaqua, N.Y. This chart covers the record of the past two years. The C.I. touched a peak of 98.8 on the week ending June 30, 1967. This preceded the 1967 high for the Dow of 943.08. The Dow high came on September 25, 1967, approximately three months after the 98.8 peak in the C.I.

From the 1967 peak, the C.I. declined to a low of 92.8 on March 8, 1968. This was accompanied by the drop in the Dow from the 1967 peak of 943.08 to the March, 1968 low of 825.13. Following the early 1968 low point, the C.I. again rallied, touching a 1968 high of 97.1 during the third week of July. At the same time the Dow was rallying, and last week (two months after the peak in the C.I.) the Dow touched its 1968 high of

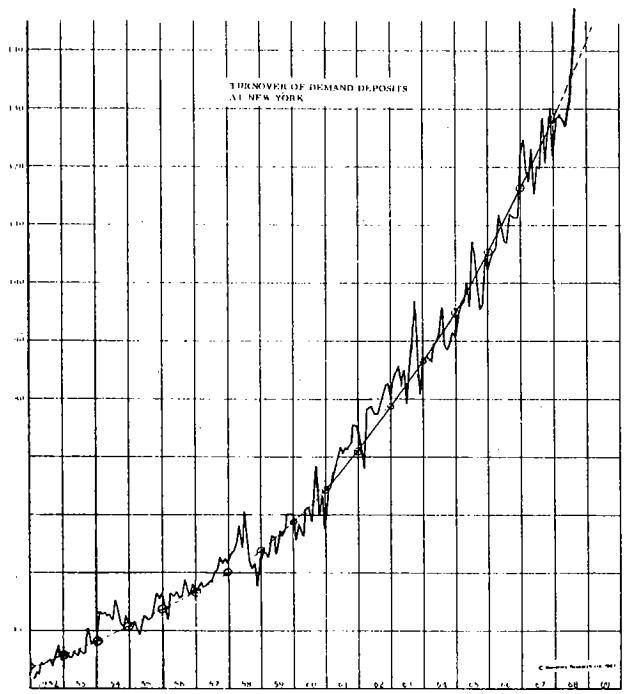
In the meantime, however, it is important to note that following the mid-1968 peak of 97.1, the C.I. plunged sharply to a low of 92.9 on August 8, 1968. This latest plunge in the C.I. occurred during the July-August period, allowing a lead time of two to four months, the C.I. is now predicting that there will be a sharp reversal in the Dow beginning in the September to November period.

Since 1967 (as seen on the weekly chart) the C.I. has been quite accurate as to coming reversals of trends in the Dow Industrials. It remains to be seen whether the July-August drop in the C.I. from 97.1 to 92.9 is predicting trouble for the Dow between now and the end of the year.

MONEY VELOCITY GOES WILD: In Letter 404 I drew attention to the turnover of demand deposits in New York. Stated simply, this is a measure of financial "activity," since it measures turnover in all New York checking accounts. The demand velocity not only tells us "where the action is," but "how much action there is." In Letter 404 I presented a long-term chart showing that money velocity in the nation's leading financial center (New York) had climbed to an annual rate of 140.3, or the highest rate since the 156 figure of 1929.

The latest figures compiled by the Bolton Tremblay Bank Credit Analyst show that velocity in New York has over the past two months expanded at an unprecedented rate to 147. Note on the chart (courtesy Bolton Tremblay) that the latest upward push has no parallel for intensity.

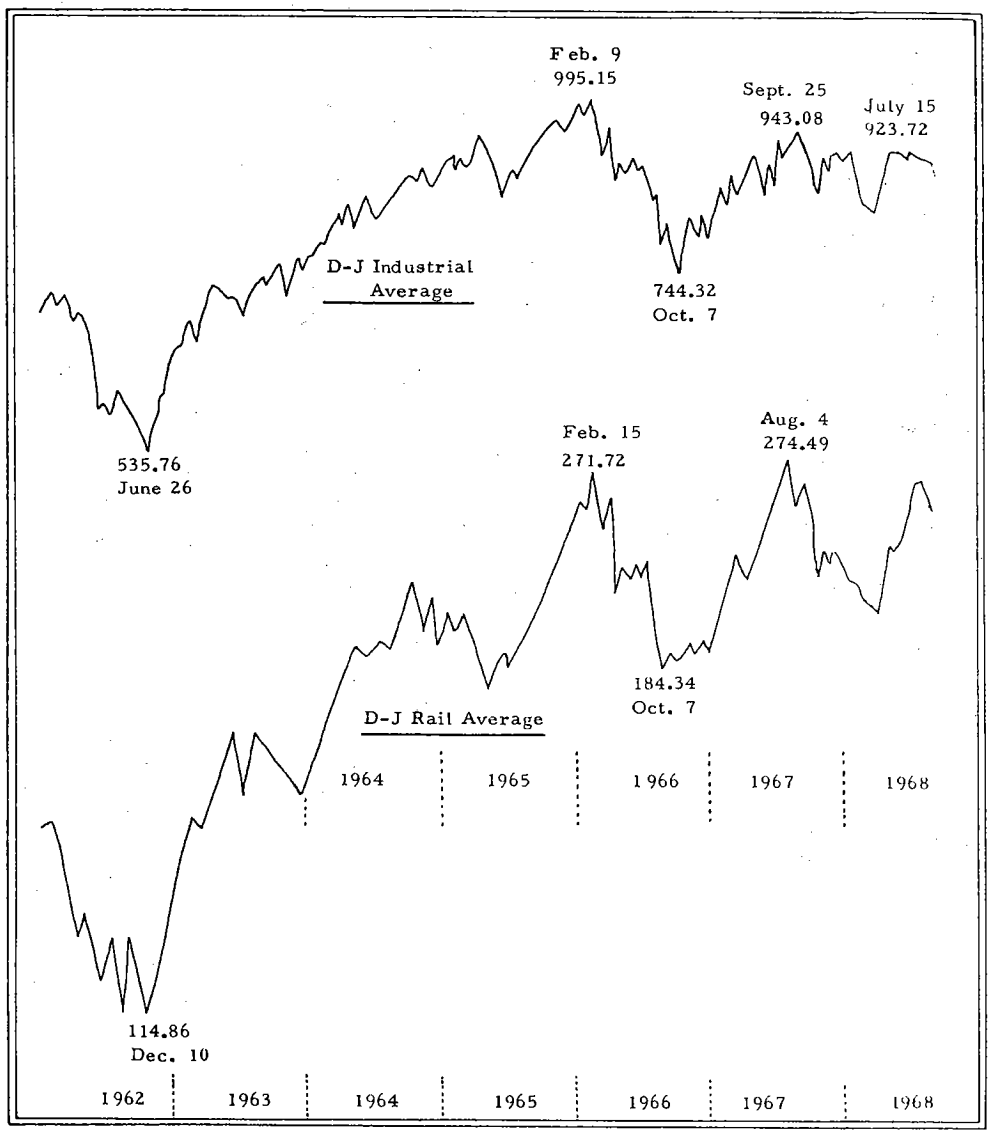
The figure of 147 means that demand deposits are now turning over in New York at roughly three times per week. We are coming closer and closer to the point of no return in money velocity. Although the velocity index topped out in 1929 at 156, there is no telling whether the index will do the same now. But as Mr. Donald R. Storey says in the current issue of the Bank Credit Analyst, "velocity tells us that we are still on the track to some eventual crisis."



THE BIG PICTURE: I have written at length about the pattern of annual declining tops in the Dow, a pattern which began at the February 9, 1966 bull market peak of 995.15. Since 1949, when the great 1949-1966 bull market began, no such pattern of declining tops for the Dow has ever appeared. As I have stated before, this series of declining tops suggests a slowly-forming primary bear market; it suggests careful distribution of blue-chip issues.

It is well to note that ever since June, 1949, it was the blue-chips (or Dow-type stocks) which led the market higher after every reaction. Now, despite pyrotechnics by growth and glamor shares, the blue chips are the laggers, and as of this writing, despite rallies and speculative excitement, the pattern of declining tops in the Dow remains intact. Even the latest sharp rally has not succeeded in altering the 1966-68 pattern, and as seen on the accompanying chart on page 5 we still have the 1966 peak of 995.15, the 1967 peak of 943.08 and the latest 1968 high of 938.28.

The first suggestion of change would be a coming rally which would take the Dow above the 1967 high (above 943.08), thus putting Industrials in position to mount an attack on the 1966 peak of 995.15. But it is fruitless to jump the gun on the barometer, and by that I mean that it is never safe to state that "the Dow will do thus and so" over the next few weeks or months. I have no doubt that the majority of analysts feel certain that the Dow will better its 1967 high between now and the end of the year. But having lived through dozens of foolers in the market, I take the position that I want the Dow to do the talking, not the analysts.



The market has a way of setting up "a sure thing," sucking everyone into the game, then turning around and doing just the opposite of what was expected. Read any newspaper or any analyst's comment just prior to a major decline or a major advance, and, in fact, I know of no better exercise than reading opinions of the times to provide one with respect for the market. As a rule, nine out of ten professionals do not foresee the possibilities of a major move prior to its inception. This is the way, unfortunately, that Wall Street so often makes fools of us all.

BRITAIN AND THE U.S.: Many American investors are betting that the U.S. markets will go the rocketing way of the London market as and if the dollar weakens. In a late column, Eliot Janeway dismisses this idea in a well reasoned column, and a few of Janeway's theses are worth repeating.

First he notes that the London market has been emptied of foreign funds, but that the American markets are loaded with foreign money. Thus, when inflation struck in London there was no flight of foreign money to knock down the British market. On the contrary, British money, blocked off from escape by stringent British legislature, found no hedge (as the pound weakened) save a flight into British equities. But a weakening dollar would be accompanied by a massive flight of foreign capital from U.S. shores, and this would be bound to hit the stock market.

Secondly, the dollar has been the big support behind the pound. But if the dollar weakens, there is no pool of foreign money to support it. The dollar is on its own, and if it starts to go it will find few if any supporters.

I have heard many comments to the effect that it is only a matter of time before the dollar weakens, and therefore we can expect a giant flight into equities as has been the case in Britain. This argument, as stated above, is far from sure.

If trouble comes, it is my opinion, that it will come from a sudden series of foreign devaluations (perhaps starting with the franc), and that such unbearable monetary dislocations will hit the dollar and set off a panic which will ultimately lead to a breakdown in international trade— then deflation.

This, then, is the danger that I see ahead. Not a slowly sagging dollar but a sudden devaluation of foreign currencies which will in turn put pressure on the dollar to devalue. Can anyone imagine what a sudden 30% devaluation of the franc would do? The news of such an event could easily start a series of monetary panics which would sweep the stock markets of the world.

I thought this column, sent to me by former student Alexander Morgen (underlines are his) was interesting enough to publish this week. It seems hardly possible that only seven years ago I had to literally "cry tears" before anyone would take technical analysis seriously. Reputable analysts ignored it, schools and colleges did not know it existed. This column provides a little past history of a movement which now has some measure of respect.

The Financial Corner

By ALEXANDER MORGEN

THE TECHNICAL SIDE OF THE STOCK MARKET

THE CURRENT STATUS OF THE TECHNICAL APPROACH TO THE STOCK MARKET

Despite criticism there has been tremendous expansion in the use of charts in the last decade. Professionals like William L. Jiler, former president of Trendline, a charting service, feels that this popularity has been carried too far.

Ten years ago, in the center of World Finance, which New York City is, there was no school, place or club where one could learn the use of charts. Anybody who tried to learn charting by himself, without instruction, without an opportunity to exchange ideas, knows what a discouraging business this can be.

The first break came in 1961 when Richard Russell, publisher of Dow Theory Letters, gave an eight session course on the interpretation of charts at the New School for Social Research. The director of the school watched in astonishment the paid attendance climb to 150 per session, when the usual cultural courses could barely meet the minimum registration of 15.

The director of the business section of the New School was bitterly opposed to the continuation of courses on charting, as this was equivalent to "dignifying Astrology with a course "at a reputable school.

But public demand was irresistable and the course continued to be given for several years, in spite of his opposition

The former director of New York Institute of Finance, ("Where Wall Street Goes to School") resisted the introduction of charting courses on entirely different grounds. He felt that the brokerage firms (or it may have been his Board of Directors) whom the school served did not like the speculative approach, which the use of chart engenders. Rightly or wrongly he maintained his stand till his retirement in 1963.

The new director of the school had no such reservations. Either because he was keenly aware of the changed attitude and increasing demand or some other reason he wasted no time in completing arrangements for instruction in the use of charts.

He selected as his instructor A. W. Cohen of Chartcraft and the first classes began in the Spring of 1964. To the surprise of no one the demand was so heavy that the school could not register all who wanted to attend. Students came not only from New York City, but all the neighboring states.

In 1965 Mr. Cohen wearied of teaching and was replaced by Alan Shaw, a technician of Harris, Upham & Co. who is the instructor there now.

Alan Shaw was a fortunate choice. It was apparent at once, that he had the qualities required of a good teacher, knowledge of the subject, intellectual honesty, unpretentious manner and genuine interest in his students.

He broadened the scope of his basic course by including Bar Charts with the Point and Figure variety first taught by Cohen.

The insatiable appetite of the people who work in Wall Street for more and more practice with charts has induced the school to offer an advanced course with limited registration.

Chart services and books on the subject have proliferated. Indicative of the new respectability of the Technical Approach are the many books on the subject written by Ph.D.'s.

Every brokerage house of any size has now on its staff someone who is known as a "technician." Many brokers publish Technical Market Letters accompanied by charts—unthinkable only a short few years ago. Others advertise courses for the "Sophisticated Investor" which invariably means an introduction to the use of charts. There is even a Technical Corner in The Wall Street Transcript, a publication devoted to making a complete record of all market letters.

How times have changed! But what about the future?

The recent Court decisions and actions of the Securities and Exchange Commission on the use of "insider" information have made corporation executives unwilling to discuss anything in private, unless it is immediately made public. Some feel that executives to be safe will say nothing and confine themselves to official reports they must issue quarterly. This may develop an increasing reliance on the technical approach. Who knows?

The use of charts will continue to increase in the foreseeable future as anybody familiar with the situation can plainly see.